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Financial Markets

Irving Trust

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Friday (Noon) Sept. 11, 1981

Interest rates moved slightly lower on balance this week, as participants recovered some of their poise following the previous week's devastation. The key to the modest improvement was the funds rate, which generally traded under 17%. The average effective rate on Federal funds has now declined in each of the last four weeks, to 16.50% in the statement week ended Wednesday.

The Fed did not conduct an expected reserves-draining operation today, prompting some suspicion that an easing of policy might be under way. However, the softening pattern in past weeks largely reflected the greater inclination of banks to borrow reserves from the discount window as the end of the quarter approaches. The reason, of course, is that the four "tickets" allotted to large banks to borrow at the 14% basic discount rate expire at the end of the calendar quarter, giving them an incentive to bid less aggressively for funds so as to use their borrowing opportunities. Recall that only four weeks ago net borrowed reserves (excluding the Fed's special extended credit) was about $1 billion, just as in the statement week ended September 3--but the average funds rate was 1.4% higher.

As we have noted before, this pattern bears some resemblance to the fund rate decline in the first quarter of this year. Then, the Fed clearly perceived the risk of a near-term acceleration in money growth--and probably does now as well. In particular, a variety of technical factors could strengthen money demand in October and subsequent months, possibly pushing the growth of the aggregates beyond the Fed's targets. That prospect--plus the resilience of the economy and credit demands--undoubtedly lies behind the Fed's cautious approach.

The much publicized political storm that erupted this week as Congress reconvened must be seen against that background. The Fed and all market participants are fully aware that its hard-won credibility has been achieved by generally sound economic analysis accompanied by impressive determination in hitting its targets. That could all be lost--with highly adverse consequences for financial markets--if the Fed were to alter its course in response to political pressures.

At this stage, such an outcome appears remote. Moreover, contrary to the suggestions of some analysts, there does not seem to be any immediate prospect of either the 14% basic discount rate or the 4% surcharge being lowered. The surcharge, for all its faults, is now a permanent part of the Fed's apparatus for maintaining discipline at the discount window. While the surcharge rate could be lowered, it probably will not be, since the discipline problem is likely to increase between now and the end of the quarter. If money growth in the next several weeks is sluggish, the basic rate could be lowered as the net borrowed reserves position declined to "near-frictional" levels. Such has not happened yet.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	9/11/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.50	20.50	12.25%
Effective since	7/8/81	7/8/81	
Discount Rate at Federal Reserve Bank	14.00	14.00	10.00
Federal Funds	16.50	16.75	10.75
Repurchase Agreements	16.00	16.75	10.00
U.S. Treasury Issues			
Bills			
3 months	15.78	16.43	10.60
6 months	16.78	17.37	11.10
1 year	16.87	17.22	11.30
Coupons			
2 years	16.70	16.85	11.42
4 years	16.30	16.36	11.40
7 years	15.74	15.63	11.45
10 years	15.43	15.45	11.35
Long Bond	14.69	14.79	11.20
Negotiable Certificates of Deposit-Secondary Market			
1 month	17.15	17.40	10.75
3 months	17.45	17.90	11.15
6 months	17.75	18.05	11.50
1 year	17.80	17.75	11.75
Banker's Acceptances			
1 month	17.10	17.45	10.70
3 months	17.50	17.85	11.20
6 months	17.75	18.10	11.60
Eurodollar Deposits			
1 month	17.63	18.13	11.00
2 months	17.75	18.44	11.44
3 months	18.00	18.69	11.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	16.25	16.75	10.50
1 month	16.63	17.13	10.63
3 months	16.63	17.00	10.50
Bank Holding Companies			
1 month	16.50	17.13	10.50
Dealer Placed:			
3 months	16.85	17.00	10.75
New AA Corporate Utility Bond	17.75	17.63	13.00
Tax Exempt			
6 month Project Notes	9.90	9.75	5.90
1 year AAA Bond	9.30	9.50	6.10
5 year AAA Bond	9.80	10.20	6.30
20 year AAA Bond	13.10	13.10	8.20

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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